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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)
MAJOR RAIL CONSOLIDATION PROCEDURES
Notice of Proposed Rulemaking

REPLY COMMENTS OF THE DOW CHEMICAL COMPANY

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Dated: December 18, 2000

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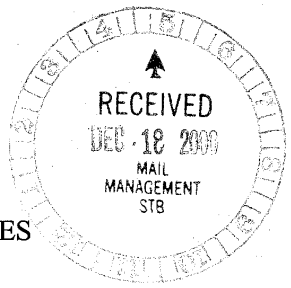

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I. Introduction

The Dow Chemical Company ("Dow") respectfully submits these Reply Comments in response to the Notice of Proposed Rulemaking ("Notice") served by the Surface Transportation Board ("STB" or "Board") in the above-captioned proceeding on October 3, 2000. Dow submitted comments in this proceeding on November 17, 2000, along with a multitude of other parties, including the U.S. Department of Transportation ("DOT"), the U.S. Department of Agricultural ("USDA"), numerous other federal and state agencies, the Association of American Railroads ("AAR"), the major Class I as well as smaller railroads, individual shippers and shipper groups, and labor.

In its opening Comments, Dow commended the Board for recognizing the need to substantially revise its rail merger policies to meet the needs of rail carriers and shippers in today's highly-concentrated rail industry. In particular, Dow was pleased with the new approach of the proposed rules to "enhance" rather than to simply "preserve" competition.

Dow nevertheless expressed concern over the lack of specificity in the proposed rules. Dow pointed out many areas where the rules were so vague or general that they fail to provide clear notice and guidance to both shippers and carriers of the standards that will be applied by the STB. In addition, the very general nature and breadth of the proposed rules would allow the Board to apply them in a manner that would result in little or no change over the existing rules.

Dow urged the Board to clarify that "enhanced competition" means "enhanced intramodal competition." Dow also encouraged the Board to clarify that a "financially sound" carrier does not mean a "revenue-adequate" carrier. Failure to make either clarification would result in no real change from the current merger policy and render the concept of "enhanced" competition purely aspirational.

Dow also reiterated its comments in the Advanced Notice of Proposed Rulemaking that the Board cannot effectively enhance competition in the rail industry by focusing exclusively upon merging carriers. This tunnel vision could in fact create uneven playing fields both among carriers and among shippers, if it doesn't discourage future mergers altogether. Moreover, it fails to address the cumulative effect of the competitive harms caused by past mergers.

Dow strongly emphasized the need for expeditious handling of rate and service disputes. Towards that end, Dow urged the Board to adopt mandatory, binding arbitration at the shipper's option. In the case of rate disputes, Dow advocated the Canadian system of Final Offer Arbitration. In addition, Dow called for the use of arbitration to resolve service disputes, service-related claims for delay, and disputes over the application of merger conditions. Without this remedy, virtually everything else the Board may accomplish in this proceeding will fail to benefit most shippers who cannot afford the time and expense of litigating before the Board and the Courts whatever remedies may otherwise be available to them.

Many commenters share Dow's sentiments and concerns. However, a large group represented by the AAR and the major Class I railroads object to the very premise of the proposed rules to "enhance", not just preserve, competition in major rail merger proceedings. Through these Reply Comments, Dow first discusses the comments of numerous parties that express concepts and concerns similar to those expressed by Dow. Second, Dow responds to the comments of the AAR and the Class I railroads who oppose the Board's emphasis on enhanced competition.

III. Many Parties Share the Concerns Raised by Dow in this Proceeding.

Dow's opening comments centered upon several general themes. With the exception of the AAR and the Class I railroads, most commenters raised similar issues and concerns.

A. The Board has properly focused upon the need for "enhanced competition."

Almost without exception, commenters agree with the Board's proposed new emphasis on "enhanced competition." The principal dissenters are the AAR and the major Class I railroads. The commenters differ, however, regarding the level of enhanced competition that is required.

Many shippers, while commending the goal, believe that the proposed rules do little to achieve it. For example, USDA argued that the Board should "promote", not just "enhance," competition. USDA Comments at 14. It asserted that the regulations fell far short of protecting the public interest and offered numerous revisions aimed at enhancing competition and protecting shippers from merger-related harm. *Id.* at 16-17, 19-21. It also objected to the Board's willingness to rely upon "voluntary offers, negotiations, and applicant proposed penalties." *Id.* at 2.

Proctor & Gamble rejected the proposed rules in their current form as unworkable. P&G Comments at 2. Expressing a concern reminiscent of the Class I railroads, P&G

argued that the rules would do nothing to alleviate harm suffered by parties actually affected by a merger. *Id.* at 3. P&G concluded that consolidations are, by their very nature, antagonistic to competition and expressed doubt that any merger could have pro-competitive effects.

The Subscribing Coal Shippers ("SCS") were similarly hostile to the proposed rules. Characterizing the rules as "well-intentioned," SCS nevertheless criticized their ambiguity and preference for carrier-proposed conditions that would yield little benefit to shippers. SCS Comments at 13.

The Joint Comments of the American Chemistry Council and the American Plastics Council ("ACC/APC") expressed serious reservations over the proposed rules. They favor the transfer of jurisdiction over mergers to the U.S. Department of Justice. However, in the absence of that statutory transfer, they offered several revisions to make the proposed rules more workable.

In general, Dow supports those commenters who have expressed grave concerns over the effectiveness of the rules as proposed. Dow has serious doubts that the rules bear much teeth or go far enough in their application. Carrier-proposed initiatives are very similar to asking the fox to watch the chicken house. Moreover, the failure to address enhanced competition in a broader context than mergers may ultimately do more harm than good. Dow's greatest concern, however, is for the ability of shippers to obtain any benefit from the proposals at all if they are not available in a cost-effective and timely manner.

B. The proposed rules require more specificity and clarification.

Every commenter, regardless of their position on the concept of "enhanced competition," asserts that the proposed rules need more specificity and clarification. Dow identified two areas in its comments, which other parties have echoed.

First, Dow asked the Board to clearly state that the references to "effective" and "enhanced" competition in proposed § 1180.1(b) and (c) means intramodal, or rail-to-rail, competition. If those phrases mean anything less, there is very little difference between the proposed standard and the current standard. This identical concern was expressed by the National Industrial Transportation League ("NITL") (p. 11), The Fertilizer Institute ("TFI") (p. 7), and numerous individual shippers.

Second, Dow asked the Board to clarify that the term "financially sound" in proposed §1180.1(c) not be equated with revenue-adequate. Dow Comments at 5-6. This concern also was raised by USDA (p. 15) and NITL (p. 13). The validity of this concern is reinforced by the comments of the AAR.

The AAR asserts that enhanced competition has "dangerous implications" for the rail industry for a variety of reasons, including "further imperil[ing] the rail industry's financial health . . . ." AAR Comments at 4-5. The AAR proceeds to argue that "freight railroads still have not attained adequate revenue levels . . . ." and therefore it "would be unwise for the Board to embrace a more activist regulatory role at a time when continued market-based innovation is needed." *Id.* at 5.

Without the clarification requested by Dow and others, the railroads can be expected to argue before the Board and the courts that, unless they are revenue-adequate, the requirement of enhanced competition does not apply to them. This would be perverse, indeed, since so few rail carriers are or ever have been revenue-adequate under the Board's standards.

C. The concept of "enhanced competition" should be expanded to the entire rail industry.

In its opening comments, Dow restated the point that "enhanced competition" must be expanded to include the entire rail industry, not just merging carriers. Dow is concerned that the limited scope of the proposed rules actually will result in competitive imbalances.

Dow's concern is reinforced by the AAR's statement that a merger that would yield substantial net public benefits might not be undertaken because the applicants would be required to sacrifice too large a share of private benefits through compliance with new competitive conditions. AAR Comments at 4. AAR's concern is well-founded to the extent pro-competitive conditions apply only to the merging carriers.

If AAR is correct, two harms will occur. First, an otherwise beneficial merger will not be consummated. Second, there will be no enhancement of competition as contemplated by the proposed rules.

Dow's concerns, however, extend beyond the unlevel playing field that could develop if only some carriers and shippers are subjected to enhanced competition. Dow strongly advocates revision of many existing pro-competitive statutory remedies. The most important of these remedies is reciprocal switching, or competitive access. Numerous commenters raised this same issue, including TFI (p. 9-10), NITL (p. 15-18), SCS (p. 11), P&G (p. 4), Edison Electric Institute ("EEI") (pp. 7-9), and DOT (pp. 5, 6)

D. Shippers require protection from merger-related service disruptions.

Shippers, as a group, shared Dow's request for greater protection from merger-related service disruptions. Their proposals are quite varied and range from "service guarantees" to compensation for losses.

Dow's comments were more narrowly focused upon the establishment of a minimum base remedy in the proposed rules, which Dow argues should be the right to short-haul a carrier with service problems at the nearest interchange point. Dow does not believe that service "guarantees" are feasible; nor does Dow advocate that the Board make itself the arbiter of service-related damage claims, other than to establish mandatory arbitration procedures for the resolution of such claims.[1] Dow, however, is concerned by the misleading comments of the Class I railroads.

[1] As Dow explained in its opening Comments, it does not believe the Board has the statutory authority to resolve damage claims.

The AAR and Norfolk Southern ("NS") argue that the Board's proposal to require "enhanced competition" to offset merger-related service disruptions suffers from a basic fallacy because such pro-competitive measures could just as easily exacerbate merger-related service problems. NS Comments at 27; AAR Comments at 13. They might have a valid point if all pro-competitive measures required trackage rights or some other form of direct access. But, they fail to recognize that "enhanced competition" can take other forms.

In its comments, Dow suggested one form of enhanced competition that could provide a remedy to shippers affected by service disruptions and contribute to a more timely resolution of the problem. That measure is to allow shippers to short-haul a carrier that is experiencing service problems. Such a measure would require the carrier, at least for the duration of the service crisis, to interchange a shipper's traffic with another carrier at the nearest feasible interchange point. By removing the traffic from the troubled carrier's system at the earliest possible point, both the shipper and the carrier obtain relief.

E. Shippers require relief from bottlenecks.

Dow's opening Comments emphasized the need to address and minimize the effects of bottlenecks upon captive shippers. Towards that end, Dow urged the Board to expressly abandon the "one-lump" theory, and more importantly, to require rail carriers to quote bottleneck segment rates regardless whether the carrier serves both the origin and destination points. Dow Comments at 12. Numerous parties asked for similar conditions.

Bottleneck rate relief is closely associated with the Board's stated objective to keep gateways open after mergers. Even the major Class I railroads no longer object to this goal absolutely. Union Pacific ("UP") Comments at 13; CSX Comments at 17; Kansas City Southern ("KCS") Comments at 27. However, most commentators have

stressed that gateways must be preserved both physically and economically. National Grain and Feed Association ("NGFA") Comments at 6-8; Alliance for Rail Competition ("ARC") Comments at 2; EEI Comments at 9-10; DOT Comments at 5; USDA Comments at 16. The latter can only occur with some assurance of a reasonable bottleneck rate.

ACC/APC urge the Board to go the farthest by adopting the "Access Condition" that they proposed in their May 16, 2000 Comments in the Advanced Notice of Proposed Rulemaking. ACC/APC Comments at 4-5. In the absence of that condition, ACC/APC have asked the Board to preserve gateways by requiring carriers to publish proportional rates to/from any interchange point to or from which the carrier published a rate prior to the merger, or to or from which the carrier carried traffic under a contract. *Id.* at 6-7. ACC/APC also urges the Board to modify the bottleneck rule in the case of merged rail systems to permit the challenge of bottleneck rates regardless whether the shipper has a signed contract from a connecting carrier. *Id.* at 8-9.

Similar arguments were made by EEI (pp. 11-12) and NGFA (pp. 6-8). Dow strongly supports these positions.

F. Arbitration is needed to provide effective remedies to the broadest range of shippers in service and rate disputes.

One of the most important points made by Dow in its opening Comments was the need for arbitration in order to ensure that both existing and proposed competitive benefits are truly available to the broadest range of shippers. Dow Comments at 12-17. Shippers, because of the time and expense of pursuing them, do not use most current regulatory protections. Shippers undoubtedly would face the same obstacles with respect to many enhanced competition measures that might arise under the proposed merger rules.

Arbitration is a concept that was embraced by many other commenters. NGFA Comments at 13; Transportation Intermediaries Association ("TIA") Comments at 3; TFI

Comments at 8-9; EEI Comments at 11-12; DOT Comments at 10. It was proposed for numerous disputes, including service disputes, damage claims, merger condition implementation disputes, and rate disputes. Although many of the proposals differ as to the role and form of arbitration, there is more than sufficient interest for the Board to seriously consider and evaluate it as an alternative to lengthy and costly regulatory and judicial proceedings.

G. Shippers must be protected from the adverse effects of acquisition premiums.

Several parties shared Dow's concern that the Board not permit acquisition premiums to adversely affect shippers. The proposed rules focus upon an enhanced scrutiny of projected merger benefits by the Board and most comments share that focus, with many urging the Board to impose penalties if projected benefits do not materialize within a specified time frame. Weyerhaeuser Comments at 7; IMC Global ("IMC") Comments at 4; SCS Comments at 20-23.

The Class I railroads object to the level of detail required by the proposed rules in calculating merger benefits and to the imposition of penalties if the benefits do not materialize. NS, in particular, contends that

> Requiring perfection and clairvoyance in merger impact analysis is therefore akin to requiring the impossible, and imposing (or threatening to impose) sanctions in the form of costly or burdensome post-approval conditions when the original merger plans cannot (even for good and sound reasons) be realized would be useless at best and counterproductive at worst.

NS Comments at 10. Dow agrees with NS' assessment of the difficulty of measuring benefits and believes that it is impractical and counter-productive to impose penalties upon a carrier if the benefits do not materialize within the projected time frames.

Nevertheless, Dow strongly concurs with EEI, and other commenters, who state that the "Board has an affirmative duty to protect customers, especially captive

customers, from increases in rates and charges, especially where acquisition premiums have been paid." EEI Comments at 11; ACC/APC Comments at 9-10; USDA Comments at 17; SCS Comments at 23. This would place the burden of over-estimating benefits on the carriers who make the projections, creating a built-in disincentive to inflate their estimates. More importantly, such protections would prevent the carriers from passing through the costs of their mergers to captive shippers.

IV. The Critique of the Proposed Rules by the Major Railroads is Unfounded.

The AAR and the major Class I railroads stand virtually alone in their opposition to the Board's proposals. Although they support attempts to revise the merger rules, the major railroads strenuously object to the proposed new emphasis upon enhanced competition. Dow believes that their objections are unfounded, and moreover, fail to address the concerns of captive shippers. Since the comments of the Class I railroads are largely repetitive of the AAR's comments, Dow will address its response primarily to those comments made by the AAR.

A. The Major Railroads Ignore the Concerns of Captive Shippers.

Although mergers can have anti-competitive effects upon all shippers, the greatest potential harm is to captive shippers of bulk commodities, such as coal, chemicals, and grain. These shippers are the most restricted in their alternatives, since intermodal options and product or geographic competition are either very limited or non-existent. As a large volume chemical and plastics shipper, Dow is extremely concerned with the ever-shrinking rail options available to it in North America. As a result, Dow's comments reflect the grave concerns of bulk shippers.

The AAR's comments appear to have been written as if there were no captive, bulk shippers. They emphasize the competitiveness of rail transportation with other modes and how mergers are driven by the need to become more competitive. This competition supposedly alleviates the need for a regulatory mandate of enhanced

competition. But this ignores the reality that railroads are still monopolists over a small, yet very significant, portion of their traffic. Those shippers are most active in this rulemaking proceeding because they are most at risk in mergers and are most dependent upon regulatory protections that they view as ineffective and unavailable in a timely and cost-effective manner.

Dow would like to eliminate the need to rely upon regulatory protections and it believes that merger conditions to enhance competition will move it closer to that goal.

B. The Board Has Authority To Impose Conditions Upon A Merger That Enhance Competition.

The AAR and the major Class I railroads fundamentally disagree with the Board's proposed emphasis upon "enhanced competition." They argue that enhanced competition is non-remedial and, therefore, is contrary to the statute and is bad public policy. AAR Comments at 1. These parties are wrong as a matter of law and policy.

1. The law does not restrict the Board to imposing conditions that alleviate only specifically identified merger harms.

The AAR crafts an elaborate argument that the statute governing the review of rail mergers permits the Board only to impose conditions to alleviate specific harms that would result from a proposed merger. AAR Comments at 15-19. The statute, however, is not so limited.

The STB shall approve mergers that are in the public interest. 49 U.S.C. § 11324(c). As the Board has properly recognized, the public interest is measured by a multitude of broad, and sometimes conflicting, factors. Notice at 12. One of those factors unquestionably is the promotion, not just the preservation, of competition. This factor appears repeatedly in the Rail Transportation Policy:

> (1) *to allow, to the maximum extent possible, competition* and the demand for services *to establish reasonable rates* for transportation by rail;

> (2) *to minimize the need for Federal regulatory control* over the rail transportation system . . .;
>
> (4) *to ensure* the development and continuation of a sound rail transportation system with *effective competition among rail carriers* and with other modes, to meet the needs of the public and the national defense;
>
> (5) to foster sound economic conditions in transportation and *to ensure effective competition* and coordination between rail carriers and other modes . . . ;
>
> (12) to prohibit predatory pricing and practices, *to avoid undue concentrations of market power*, and to prohibit unlawful discrimination;

49 U.S.C. § 10101 [emphasis added]. For nearly 20 years, the Board has interpreted these policies to require only the preservation of existing competition in rail merger proceedings. But, these policies are stated in a proactive tense. Thus, it is entirely within the Board's discretion to emphasize the enhancement of competition, as it has done in the proposed rules.

The AAR is correct that the statute instructs the Board to consider "whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system." 49 U.S.C. § 11324(b)(5). But, this provision of the statute sets forth only minimum factors that the Board must consider. It does not preclude the Board from considering other factors relevant to the public interest, including any factors that would promote the Rail Transportation Policy.

The AAR also is correct that the Board may impose conditions to alleviate the anti-competitive effects of a transaction. But that section also is not limited to only that circumstance. Rather, the statute broadly states that:

> The Board shall approve and authorize a transaction under this section when it finds the transaction is consistent with the public interest. The Board may impose conditions governing the transaction, including the divestiture of parallel tracks or

> requiring the granting of trackage rights and access to other facilities.

49 U.S.C. § 11324(c). This provision does not restrict the Board's conditioning authority to remedying specific anti-competitive effects. Although the provision proceeds to mandate that any "trackage rights and related conditions imposed to alleviate anti-competitive effects of the transaction shall provide for operating terms and compensation levels to ensure that such effects are alleviated", it should not be read to limit the preceding sentences only to that circumstance.

The AAR also argues that enhanced competition is contrary to the Board's past interpretations of the statute. These past precedents, however, were based upon the current merger policy, which gives a greater emphasis to factors other than competition. The STB, through this rulemaking, can make a reasoned decision that its merger policy should be revised in light of changed circumstances.

2. Public policy favors "enhanced competition" in the rail industry.

The AAR's objections to "enhanced competition" are based on a very perverse logic. For example, the AAR contends:

> The Board's proposed change in policy regarding mandatory conditions unrelated to the effects of a merger would represent an unfortunate shift away from reliance on market forces, which was the defining character of Staggers Act regulatory reforms, to a much greater emphasis on regulatory judgment and intervention.

AAR Comments at 6. It is truly ironic that the AAR would object to conditions that would increase reliance on market forces on the grounds that such conditions must be imposed by regulatory action. If sufficient market forces existed, regulatory action would be unnecessary.

As a matter of policy, the AAR is critical of government mandated competition as opposed to private sector initiatives that result in more vigorous competition. AAR Comments at 2. It points to the trackage rights granted to BNSF in the UP/SP merger and

to the Conrail Shared Asset Areas as examples of such initiatives working under the status quo. These arguments, however, are very misleading.

First, it is not entirely accurate to characterize them as "voluntary." These initiatives were designed primarily to address a significant loss of intramodal competition as a consequence of the proposed transactions and to eliminate significant opposition to a merger from other rail carriers. Without such proposals, those mergers likely would not have been approved. Moreover, the Shared Asset Areas in the Conrail transaction were a response to a clear signal from the STB that pro-competitive proposals might be required in order to obtain Board approval. Thus, it is somewhat disingenuous to call prior private sector initiatives "voluntary" when they were designed to address clear regulatory standards.

Second, the true competitive benefits of those initiatives may be overstated. As Dow emphasized in its opening Comments, truly effective intramodal competition does not exist today unless both the origin and destination are served by the same two rail carriers or the bottleneck carrier is neutral. Dow Comments at 7. Otherwise, the bottleneck carrier at either end will preclude the participation of the competing carrier at the other end. Very few points are served by two rail carriers at all, much less having the same two carriers serve both the origin and destination points. Furthermore, as a result of the rail duopolies east and west of the Mississippi River, a bottleneck carrier is likely to be neutral only when the origin and destination points are on opposite sides of the River. This significantly reduces the benefits of Shared Asset Areas and other "voluntary" initiatives from past mergers.[2]

In many ways, the Board's proposed rules still rely upon the same type of "voluntary" industry initiatives as past mergers. The merging carriers are required to

[2] But for the Board's "Bottleneck Decisions", *Central Power & Light Co. v. Union Pacific R.R. Co.*, Nos. 41242 et al., 1996 STB LEXIS 358 (served Dec. 31, 1996), *clarified* 1997 STB LEXIS 91 (served May 1, 1997), these private sector initiatives would be of greater competitive benefit to shippers by eliminating the requirement that the bottleneck carrier be neutral.

propose measures to enhance competition. Moreover, the rules encourage cooperation and consultation with shippers by giving greater weight to proposals that have shipper support. This is remarkably similar to the way prior merger proceedings have played out. The Board's proposed rules appear to codify the existing process, but express a greater emphasis on enhancing, in addition to preserving, competition.

Respectfully submitted,

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December 18, 2000

Certificate of Service

I certify that I have this 18th day of December 2000, served copies of the "Reply Comments of The Dow Chemical Company" upon all parties of record in this proceeding, by First Class mail.

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